

CITY SECURITIES WEALTH ADVISORS

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February 16, 2009

Last week I introduced the concept of financial margin by sharing a few client stories where proper margins significantly improved their ability to prepare for the future, handle personal set-backs, and improved their emotional response to the current crisis. Today the markets and our office are closed for President's Day, so I will continue our discussion of margins by defining what I believe good personal financial margins look like.

I began writing about the concept of financial margin during my annual year-end planning this past New Year holiday. At that time, I noted that a successful financial planning client should not be dependent on more than roughly 60% of their net income resources (a 40% margin). Last week, as I was measuring the square inches on my letter-size paper with one-inch margins for the illustration in my letter, I was amazed that such a visually modest margin resulted in using only 63% of the available space on the paper - the margin was 37%. The implication for financial margin is that a margin of 35% to 40%, which seems far too big in percentage terms, actually looks quite reasonable since it only affects the edges of our life. But it has a huge impact on how cluttered and stressful, or how organized and flexible our life is.

Here is how I would propose calculating your own financial margin: savings and discretionary expenses divided by net income after taxes. The formula looks like this...

$$\text{Financial Margin} = \frac{\text{Savings and Discretionary Expenses}}{\text{Net Income After Taxes}}$$

Net income after taxes is pretty simple. Just take your total annual income and subtract the federal, state, local and employment (Social Security and Medicare) taxes you paid. Other taxes, such as property and sales taxes, can be ignored since they are part of expenses and not tied to your income level. Determining savings is also simple and usually limited to retirement plan contributions, education plans, and other long term savings. Savings does not include money that is set aside but later spent. Discretionary expenses are more difficult and subjective, with some gray areas. An easy test is to ask if a given expense can be stopped quickly (within 30 days), then not resumed for an extended period of time, and doing so wouldn't cause you undue stress...these would be discretionary.

If you started shaking at the mere sight of a math formula, just let me know and my office can discuss the components with you and calculate your financial margin.

I am aware that targeting a 40% financial margin may seem ridiculous, and possibly un-American, to some. But keep in mind that we are only talking about a one-inch border around the edges of the page. I am also aware of the difficulty of creating this margin from a life that currently has zero margins - but it is worth it. I have reviewed the finances of well over a thousand families in the last thirteen years - many of them have this kind of margin and are successfully building sustainable wealth, while others are feeling the personal and relational stresses that occur when margins are too narrow or nonexistent.

Please do not hesitate to contact me if you have any questions about this concept or other aspects of your personal finances. I would welcome speaking with you and helping to create a one-inch margin. I may write you again this week as we continue to evaluate present economic and market conditions. Then I'll be heading to Washington, D.C. for meetings and a visit with family late this week and early next week.

All the best,

A handwritten signature in black ink, appearing to read "Kenneth R. Klabunde". The signature is fluid and cursive, with the first name being the most prominent.

Kenneth R. Klabunde, MS, CFP®
Vice President